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The SEC's New Regulation CE Exemption: Federal-State Coordination Run Rampant

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The SEC's New Regulation CE Exemption: Federal-State Coordination Run Rampant

C. STEVEN BRADFORD*

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I. INTRODUCTION

The Securities and Exchange Commission ("SEC") recently adopted a novel exemption from the registration requirements of the

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Securities Act of 1933.¹ This new exemption, Regulation CE, contains a single rule, Rule 1001, that exempts from registration “[o]ffers and sales of securities that satisfy the conditions of paragraph (n) of Sec. 25102 of the California Corporations Code. . . .”² California section 25102(n), in turn, exempts offerings to “qualified purchasers” and includes a “test-the-waters” provision that allows issuers to solicit purchasers in writing, even if non-qualified investors receive the solicitation.³

Regulation CE is part of the SEC’s continuing effort to ease the regulatory burdens on small businesses issuing securities. The intent of the regulation is to facilitate capital raising by small businesses by providing a coordinated federal-state exemption, without sacrificing investor protection.⁴

Regulation CE is the first coordinated federal-state exemption that defers to the state exemption. While states have previously adopted exemptions from state registration tied to compliance with federal exemptions,⁵ this is the first transaction exemption adopted by the SEC that defers to a state exemption. The basic idea underlying Regulation CE—allowing issuers to solicit qualified purchasers—is sensible, but the SEC’s execution of that idea creates a regulatory quagmire. In essence, the SEC is giving California authorities the power to determine the scope of an exemption from federal securities law. Regulation CE’s delegation of authority to California state officials probably exceeds the SEC’s regulatory authority. In addition, the language of Regulation CE effectively allows California officials to amend the federal exemption without further proceedings at the federal level—a possible violation of the federal Administrative Procedure Act. Finally, applying Regulation CE to so-called “covered securities” violates the preemption provisions Congress recently added to section 18 of the Securities Act.

Even if Regulation CE is valid, the interaction of federal law and California law presents difficult interpretive questions. For instance, as drafted, calculation of the “aggregate offering price” of a Regulation CE offering is troublesome. Additionally, the application of the integration

1. 15 U.S.C. § 77a-77aa (1994) [hereinafter “Securities Act”].

2. 17 C.F.R. § 230.1001(a) (1997). Regulation CE was proposed in 1995, Exemption for Certain California Limited Issues, Securities Act Release No. 7185, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,636 (June 27, 1995), and adopted in May 1996, Small Business Registration Exemption, Securities Act Release No. 7285, [1996 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,803 (May 1, 1996). It became effective on June 10, 1996. Exemption for Certain California Limited Issues, 61 Fed. Reg. 21356 (1996).

3. See CAL. CORP. CODE § 25102(n) (Deering 1997).

4. See Securities Act Release No. 7285, *supra* note 2, at 88,007.

5. See JOSEPH C. LONG, BLUE SKY LAW §§ 5.06[1], 5.06[3] (rev. ed. 1997); HUGH L. SOWARDS & NEIL H. HIRSCH, BLUE SKY REGULATION §§ 5.02, 5.03[4], 5.03[6] (rev. ed. 1997).

doctrine to Regulation CE offerings is confusing. If the SEC had drafted the regulation more carefully, these problems could have been avoided.

This article first introduces and outlines the Regulation CE exemption—a task that can only be fully accomplished by also reviewing the requirements of section 25102(n) of the California Corporations Code. The accompanying appendix to this article focuses, in particular, on the definition of “qualified purchaser” and the wandering trail one must follow to give content to that term. The article then examines the SEC’s authority to adopt an exemption like Regulation CE and whether Regulation CE is consistent with section 18 of the Securities Act. Finally, the article examines the difficult interpretive issues this new type of federal-state coordination raises—in particular, the determination of the “aggregate offering price” of a Regulation CE offering and the application of the integration doctrine to Regulation CE offerings.

II. AN OVERVIEW OF THE REGULATION CE EXEMPTION

Regulation CE incorporates section 25102(n) of the California Corporations Code by reference. Thus, some of the requirements of the federal exemption depend on California law. However, Regulation CE imposes additional requirements at the federal level. I will first discuss the state law requirements of California section 25102(n), then discuss the additional requirements added by Regulation CE itself.

A. *State Requirements*

1. ELIGIBLE ISSUERS

Section 25102(n) is available to California corporations, other business entities organized under California law, and other corporations with substantial California ties.⁶ A non-California corporation can use subsection (n) if two conditions are met: (1) more than 50 percent of its outstanding voting securities are held of record by persons with California addresses; and (2) the average of its percentages of property, payroll, and sales in California, as determined for state tax purposes, is greater than 50 percent.⁷ The section 25102(n) exemption is not available to so-called “blind pool” issuers or to investment companies subject to the Investment Company Act of 1940,⁸ nor is it available for rollup transactions.⁹

6. See CAL. CORP. CODE § 25102(n)(1).

7. See CAL. CORP. CODE §§ 25102(n)(1), 2115.

8. See *id.* A blind pool company is one “organized for the sole purpose of raising capital to invest in future unknown businesses.” California Commissioner of Corporations, Release No. 94-C, 1 BLUE SKY L. REP. (CCH) ¶ 12,628, at 8128 (Sept. 27, 1994).

9. See CAL. CORP. CODE § 25102(n) (Deering 1997).

2. QUALIFIED PURCHASERS

Section 25102(n) exempts from the California qualification requirements offers and sales to "qualified purchasers" or to persons the issuer reasonably believes, after reasonable inquiry, to be "qualified purchasers."¹⁰ Determining who is a "qualified purchaser" can be a difficult task, not because of the concepts involved, which are relatively straightforward, but because of the confusing labyrinth of statutes and regulations one must navigate. Section 25102(n) includes its own definitions of qualified purchasers, but it also incorporates qualified purchaser definitions from other statutory provisions and regulations; these other rules, in turn, incorporate yet other definitions.¹¹ In addition, there is definitional duplication; some types of purchasers are covered via several different routes, sometimes with slightly different definitions.¹² This unnecessarily confusing system of multiple cross-references has already caused disagreement between the SEC and the California Commissioner of Corporations as to the meaning of one of the categories.¹³

10. See CAL. CORP. CODE § 25102(n)(2).

11. For example, section 25102(n) provides that any person designated in title 10, section 260.102.13 of the California Code of Regulations is a qualified purchaser. See CAL. CORP. CODE § 25102(n)(2)(A). Section 260.102.13, in turn, designates any accredited investor as defined in Rule 501(a) of federal Regulation D. See CAL. CODE REGS. tit. 10, § 260.102.13(g) (1997).

12. For example, the section 25102(n) definition of qualified purchaser includes section 501(c)(3) charitable organizations with total assets in excess of \$5 million. See CAL. CORP. CODE § 25102(n)(2)(D). The qualified purchaser definition also includes persons designated in the exemption in section 25102(i) or rules adopted thereunder. See *id.* § 25102(n)(2)(B). One of the subdivision (i) rules designates section 501(c)(3) organizations with total assets of at least \$5 million. See CAL. CODE REGS. tit. 10, § 260.102.10(a). The § 25102(n) qualified purchaser definition includes persons designated in section 260.102.13 of the California regulations. See CAL. CORP. CODE § 25102(n)(2)(A). These regulations include any person who falls within the definition of "accredited investor" in Rule 501(a) of Regulation D. See CAL. CODE REGS. tit. 10, § 260.102.13(g). The definition of "accredited investor" in Rule 501(a) includes section 501(c)(3) organizations with total assets in excess of \$5 million. See 17 C.F.R. § 230.501(a)(3).

13. The term "qualified purchaser" includes any person designated in section 25102(i) of the California Corporations Code or any rule of the Commissioner of Corporations adopted thereunder. See CAL. CORP. CODE § 25102(n)(2)(B). Subsection (i) exempts, *inter alia*, offers or sales to corporations with outstanding securities registered under section 12 of the Exchange Act, "that after the offer and sale will own directly or indirectly 100 percent of the outstanding capital stock of the issuer." CAL. CORP. CODE § 25102(i)(2). The SEC's Regulation CE releases interpret the subsection (n)(2)(B) cross-reference as incorporating not just the restriction on the type of purchaser (section 12 registrants), but the transactional restriction as well (a 100 percent acquisition). See Securities Act Release No. 7285, *supra* note 2, at 88,008 ("reporting companies under the Securities Exchange Act of 1934 . . . , if the transaction involves the acquisition of all of an issuer's capital stock for investment"). The California Commissioner of Corporations apparently believes that the cross-reference is intended to restrict only the type of purchaser, and is not intended to incorporate the additional transactional restriction. In a release interpreting subsection (n), the Commissioner included, as qualified purchasers, "corporations with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934," without mentioning the 100-percent-purchase requirement. California Commissioner of Corporations, Release No. 94-C, *supra* note 8, at 8128.

The Appendix to this article contains an exhaustive listing of the categories of qualified purchasers. The Appendix eliminates identical items and lists qualified purchasers by category. Notes indicate where more than one definition makes a particular person qualified. Where two categories of qualified purchasers differ in some way, both items have been retained, even if it appears that one definition clearly incorporates the other. In reviewing this list, two things need to be kept in mind. First, organizations formed specifically for the purpose of acquiring the securities being offered are qualified purchasers only if all of the equity owners of the organization are qualified purchasers.¹⁴ Second, because of the cross-references, the list of qualified purchasers can change even if Regulation CE and section 25102(n) do not change in any way.

3. SOLICITATION RESTRICTIONS

Section 25102(n) restricts the solicitation of offerees. Telephone solicitation is not allowed until the issuer has determined that a prospective purchaser is qualified.¹⁵ However, an issuer may "test the waters" by publishing a written general announcement of the proposed offering.¹⁶ Disseminating this announcement need not be limited to qualified purchasers; the exemption is available even if non-qualified purchasers receive it.¹⁷

The announcement must contain the name of the issuer, the full title of the security to be issued, the anticipated suitability standard for prospective purchasers, and any other information the California Commissioner of Corporations requires by rule to be included.¹⁸ It must also include statements providing that no money or other consideration is being solicited or will be accepted, that an indication of interest will not obligate the purchaser, and that, if a disclosure statement is required, it will be provided at least five business days before any sale is finalized.¹⁹ Finally, the announcement must contain the following legend: "For more complete information about (Name of Issuer) and (Full Title of Security), send for additional information from (Name and Address) by send-

14. See CAL. CORP. CODE § 25102(n)(2) (Deering 1997).

15. See CAL. CORP. CODE § 25102(n)(6). Neither the statute nor the California Commissioner of Corporations, Release No. 94-C, *supra* note 8, say anything about face-to-face oral solicitations. However, in the releases proposing and adopting Regulation CE, the SEC indicated that oral offers were limited to qualified purchasers. See Securities Act Release No. 7285, *supra* note 2, at 88,008 ("Offers, oral or written, are generally limited to qualified purchasers."); see also Securities Act Release No. 7185, *supra* note 2, at 86,873 (identical language).

16. See CAL. CORP. CODE § 25102(n)(5).

17. See *id.* § 25102(n)(5)(D).

18. See *id.* § 25102(n)(5)(A)(i)-(iii), (v).

19. See *id.* § 25102(n)(5)(A)(iv).

ing this coupon or calling (Telephone Number)."²⁰

In addition to the required information, the announcement may include any of the following information: a brief description of the issuer's business, the geographic location of the issuer and its business, the price of the security or the method used to determine the price, and the aggregate offering price of the securities being offered.²¹ No other information may be included.²²

4. DISCLOSURE REQUIREMENT

The issuer must give a written disclosure statement to most, but not all, purchasers who are natural persons, and entities specifically formed by such natural persons for the purpose of acquiring the securities offered by the issuer.²³ The purchaser must receive the disclosure statement at least five business days before the securities are sold or a commitment to purchase is accepted from the purchaser.²⁴ The disclosure statement must meet the disclosure requirements of Regulation D of the Securities Act and must also contain any other information required by the California Commissioner of Corporations.²⁵ An inadequate disclosure statement will not destroy the exemption,²⁶ but presumably, the issuer would lose the exemption if it failed to deliver any disclosure statement at all.

5. INVESTMENT INTENT

Each purchaser in a section 25102(n) offering must represent that the purchased securities are for his own account (or for a trust account, if the purchaser is a trustee), and were not purchased with a view to distribution.²⁷ Although section 25102(n) does not expressly restrict resales, this oversight is mooted for purposes of Regulation CE by the direct federal restriction on resales.²⁸

6. FILING REQUIREMENT AND FEES

An issuer using subsection (n) must file two notices with the Cali-

20. *Id.* § 25102(n)(5)(A)(vi).

21. *See id.* § 25102(n)(5)(B).

22. *See id.* § 25102(n)(5)(C).

23. *See id.* § 25102(n)(4). A disclosure statement is not required for natural persons who qualify under title 10, section 260.102.13 of the California Code of Regulations. *See id.*

24. *See* CAL. CORP. CODE § 25102(n)(4) (Deering 1997).

25. *See id.*

26. *See id.*

27. *See id.* § 25102(n)(3).

28. *See infra* text accompanying notes 36-38.

for California Commissioner of Corporations.²⁹ The first notice must be filed either concurrently with the publication of any general announcement of the proposed offering or at the time of the initial offer of the securities, whichever comes first.³⁰ It must contain an undertaking to deliver to the Commissioner of Corporations within ten days of the Commissioner's request the disclosure statement required to be given to natural persons.³¹ The issuer must also pay a filing fee, currently \$600, when the first notice is filed.³² If the issuer does not file the first notice or pay the filing fee, the exemption is not available.³³ The issuer must file a second notice within ten business days following the close or abandonment of the offering, but not more than 210 days after the filing of the first notice.³⁴

B. Federal Requirements

Regulation CE imposes only two federal requirements independent of what California requires. First, the Regulation CE offering amount is limited to \$5 million.³⁵ Second, Regulation CE provides that securities issued in a Regulation CE transaction are "restricted securities" within the meaning of Rule 144.³⁶ The securities may be resold only if the resale is registered with the SEC or an exemption is available for the resale.³⁷ The SEC viewed this resale restriction as consistent with the California requirement of investment intent.³⁸

III. INCORPORATION OF A STATE EXEMPTION BY REFERENCE

A. Introduction

The SEC viewed Regulation CE as a way to extend the "test-the-waters" concept of Regulation A to private offerings.³⁹ According to the SEC, "the inability to reach out broadly to find potentially qualified

29. See CAL. CORP. CODE § 25102(n)(7). For the forms of the two notices, see California Commissioner of Corporations, Release No. 94-C, *supra* note 8, at 8129.

30. See CAL. CORP. CODE § 25102(n)(7) (Deering 1997).

31. If the statement is not delivered within the specified time, the Commissioner may assess a penalty of up to \$1000. See *id.*

32. See California Commissioner of Corporations, Release No. 94-C, *supra* note 8, at 8129.

33. See *id.*

34. See CAL. CORP. CODE § 25102(n)(7) (Deering 1997).

35. See 17 C.F.R. § 230.1001(b) (1997).

36. See *id.* §§ 230.1001(c), 230.144(a)(3)(E).

37. See *id.* § 230.1001(c).

38. See Securities Act Release No. 7285, *supra* note 2, at 88,009. The SEC did not indicate why Rule 1001, which defers to California state law on so many other issues, does not defer to California law on the issue of resales.

39. See Securities Act Release No. 7285, *supra* note 2, at 88,008 ("The California exemption combines a form of general solicitation using a 'test the waters' concept with a qualified purchaser concept . . .").

investors for Regulation D exempt offerings hampers the utility of the exemption and may raise the costs to companies of trying to do these exempt offerings.”⁴⁰ Regulation CE allows issuers to solicit qualified investors without fear that contact with unqualified investors will destroy the exemption.

Although the SEC may have had reason to lessen Regulation D burdens with a “test-the-waters” provision, it is unclear why the SEC incorporated the California exemption instead of simply creating a similar federal exemption. It could easily have extended the “test-the-waters” concept to Rules 505 and 506 of Regulation D.⁴¹

A federal exemption would have been available to all issuers, not just California issuers. If such an exemption is a good idea, there is no basis for limiting its availability to California. If it is not a good idea, limiting it to California will not make it any better. Two comment letters on the SEC proposal suggested a federal, instead of a state-by-state, approach; the SEC merely promised to consider those suggestions in the future.⁴² Confining the exemption to California might be justified if the SEC believed California was uniquely capable of securities law enforcement, but that clearly was not the SEC position. The SEC’s Regulation CE proposal offered “to provide the same exemption for each state that enacts a transaction exemption incorporating the same standards used by California.”⁴³

This is the first time the SEC has incorporated a state exemption by reference,⁴⁴ and it appears the SEC has not recognized the difficult legal issues created by deferring to state law. First, Regulation CE may be an unconstitutional delegation of the SEC’s regulatory authority to California state officials. Second, the structure of Regulation CE may create future problems under the Administrative Procedure Act if the Califor-

40. Securities Act Release No. 7185, *supra* note 2, at 86,875.

41. On the same day it released the Regulation CE proposal, the SEC released a proposal to allow issuers to “test the waters” prior to a registered public offering. *See* Solicitations of Interest Prior to an Initial Public Offering, Securities Act Release No. 7188, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,639, at 86,890-91 (June 27, 1995). When the SEC proposed Regulation CE, it indicated that it was considering altering the general solicitation restrictions in Regulation D. *See* Securities Act Release No. 7185, *supra* note 2, at 86,785. The SEC eventually deferred consideration of that issue. *See* Securities Act Release No. 7285, *supra* note 2, at 88,010.

42. *See* Securities Act Release No. 7285, *supra* note 2, at 88,009-88,010 n.35.

43. *See* Securities Act Release No. 7185, *supra* note 2, at 86,874.

44. The amount of the Rule 504 exemption at one time depended on whether all or part of the offering was state-regulated, but the rule did not incorporate any state requirements. *See* Regulation D Revisions, 53 Fed. Reg. 7866 (Mar. 10, 1988). The closest provision to Regulation CE is probably the section 3(a)(10) statutory exemption, which is available only where there is a state fairness hearing. *See* 15 U.S.C. § 77c(a)(10) (1994). However, section 3(a)(10) was adopted by Congress, not the SEC, and its reference to state law is much less specific than that in Regulation CE.

nia rules are amended. Third, the application of Regulation CE to "covered securities" may violate section 18 of the Securities Act. The SEC did not address any of these issues when it adopted Regulation CE.

B. *The Constitutionality of the SEC's Delegation of Authority*

Congress gave the SEC the authority to exempt offerings from the Securities Act of 1933.⁴⁵ Regulation CE may, nonetheless, be an unlawful delegation of that authority to the California Legislature and the California Commissioner of Corporations. If the California Legislature amends California section 25102(n) or the statutory provisions it cross-references, or the California Commissioner of Corporations amends the California regulation's section 25102(n) cross-references, the federal exemption changes.⁴⁶

Federal courts have considered many challenges to federal agencies' subdelegation of regulatory authority; however, most of those cases have involved delegation of authority within the agency—from the head of the agency to subordinates.⁴⁷ In that context, courts generally permit subdelegation, unless Congress has prohibited or limited it.⁴⁸ Moreover, the issue is much simpler, because the head of the federal agency still retains direct control over the subordinate decision-maker. When authority is delegated outside the federal agency, the federal agency has significantly less control. Delegation of federal authority to state or lesser governmental or quasi-governmental bodies are rare, and courts have been divided in the few cases that have raised the issue. Some of those cases invalidated federal regulations delegating authority to states

45. See 15 U.S.C. §§ 77c(b), 77z-3.

46. The release adopting Regulation CE acknowledges that California authorities may unilaterally change the federal exemption. The SEC stated that:

One commenter expressed the view that the Commission should key the exemption to Sec. 25102(n) as it existed at the time it originally became effective. The Commission has determined to adopt Rule 1001 as proposed in order to allow California flexibility to address concerns relating to its exemption without fear of losing the federal counterpart. Nevertheless, the Commission will monitor future changes to the California exemption to assure that the investor protections are not diminished in a fashion that would warrant modification of the federal exemption.

Securities Act Release No. 7285, *supra* note 2, at 88,009 n.27.

47. See 1 KENNETH CULP DAVIS & RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 2.7 (3d ed. 1994), and cases cited therein.

48. See *id.* at 88.

or other authorities,⁴⁹ while others approved such delegation.⁵⁰

One important factor in these cases is whether the non-federal delegatee has final decision-making authority or the federal agency retains the power to review the decision independently after the state authority acts.⁵¹ Even when authority is delegated within a federal agency, "[t]he courts have consistently required subdelegation of significant functions to be checked by some form of review, either within the agency itself, or ultimately by the courts."⁵² In the cases that approved subdelegation to governmental authorities outside the agency, the federal authority retained the ultimate decision-making power.⁵³ A Ninth Circuit case, *Assiniboin & Sioux Tribes v. Board of Oil & Gas Conservation of Montana*,⁵⁴ illustrates this point nicely. The Bureau of Land Management ("BLM") of the Department of the Interior had jurisdiction over the location of oil and gas wells on lands held in trust for the plaintiff Indian tribes.⁵⁵ The BLM entered into an agreement with the Montana Board of Oil and Gas Conservation requiring permit applicants initially to submit the matter to the State Board. The State Board's orders would become effective only after approval by the BLM.⁵⁶ The tribes argued that the BLM did not conduct an independent review, but merely rubber-stamped the State Board's decisions.⁵⁷ The Ninth Circuit held that if the tribes could prove there was no independent federal review, the BLM's

49. See *Vierra v. Rubin*, 915 F.2d 1372, 1377-79 (9th Cir. 1990) (invalidating regulation issued by Secretary of Health and Human Services delegating "good cause" determination to states); *Planned Parenthood v. Heckler*, 712 F.2d 650, 663 (D.C. Cir. 1983) (invalidating regulation issued by the Secretary of Health and Human Services requiring grantees to comply with state laws requiring parental notification and consent when prescribing contraceptives); *Pistachio Group of the Ass'n of Food Indus., Inc. v. United States*, 671 F. Supp. 31, 33-36 (Ct. Int'l Trade 1987) (invalidating International Trade Administration regulation incorporating exchange rates set by the Federal Reserve Bank of New York). See also *Assiniboine & Sioux Tribes v. Board of Oil & Gas Conservation*, 792 F.2d 782, 796 (9th Cir. 1986) (refusing to approve Bureau of Land Management agreement delegating authority to Montana State Board of Oil and Gas Conservation regarding drilling applications on Indian tribal trust land, absent further evidence concerning the scope of the subdelegation).

50. See *Southern Pacific Trans. Co. v. Watt*, 700 F.2d 550, 556 (9th Cir. 1983) (approving regulation adopted by the Secretary of the Interior requiring tribal consent to the grant of a railroad right-of-way); *United States v. Matherson*, 367 F. Supp. 779 (E.D.N.Y. 1973) (approving regulation adopted by the Superintendent of the Fire Island National Seashore requiring applicants to obtain a permit from adjoining towns prior to obtaining a permit to use motor vehicles on the Seashore).

51. See *Matherson*, 367 F. Supp. at 782-83.

52. *Pistachio*, 671 F. Supp. at 36, and authorities cited therein.

53. See *Assiniboine*, 792 F.2d at 794-95; *Matherson*, 367 F. Supp. at 783; *Pistachio*, 671 F. Supp. at 36.

54. 792 F.2d 782 (9th Cir. 1986).

55. See *id.* at 785.

56. See *id.* at 786.

57. See *id.* at 793.

procedures would be an unlawful delegation of authority.⁵⁸

The SEC's delegation to California authorities in Regulation CE is absolute. Offerings that comply with the state law are exempt without any further SEC action. If California changes its exemption, the federal Regulation CE exemption also changes, without SEC approval. The SEC has indicated that it will monitor future changes to the California exemption,⁵⁹ but the SEC can revoke or restrict its delegation to California authorities only by modifying Regulation CE through further rule making. This unbridled delegation of SEC authority is difficult to justify.

Congress, in section 4A of the Exchange Act,⁶⁰ authorized the SEC to delegate some of its functions; that section, however, is not helpful and may even be detrimental to the case for Regulation CE. First, section 4A only authorizes the delegation of authority "to a division of the Commission, an individual Commissioner, an administrative law judge, or an employee or employee board."⁶¹ The delegation to state officials in Regulation CE is outside the scope of that authorization. Second, section 4A does not authorize the delegation of general rule-making functions.⁶² Regulation CE delegates to California the authority to determine the content of a federal rule. Section 4A may, in fact, aggravate the subdelegation problem. Congress' limited grant of the authority to delegate could preclude the SEC from delegating its authority to other officials.⁶³

C. A Problem Under the Administrative Procedure Act

The SEC's incorporation of California law also presents a problem under the federal Administrative Procedure Act ("APA").⁶⁴ Substantive legislative rules, such as Regulation CE, are subject to the APA's notice-

58. *See id.* at 795.

59. *See* Securities Act Release No. 7285, *supra* note 2, at 88,009 n.27.

60. 15 U.S.C. § 78d-1 (1994).

61. *Id.* § 78d-1(a).

62. Section 4A provides:

Nothing in this section shall be deemed to supersede the provisions of section 556(b) of title 5, or to authorize the delegation of the function of rule-making as defined in subchapter II of chapter 5 of Title 5, United States Code with reference to general rules as distinguished from rules of particular applicability, or of the making of any rule pursuant to section 78s(c) of this title.

15 U.S.C. § 78d-1(a).

63. *See* *United States v. Giordano*, 416 U.S. 505, 513-23 (1974) (holding that a specific grant of authority to "[t]he Attorney General, or any Assistant Attorney General specially designated by the Attorney General" prohibited the Attorney General from subdelegating his authority to anyone other than an Assistant Attorney General). However, the Court relied on legislative history that the Court believed indicated Congress' intent to limit delegation. *See id.* at 516-22.

64. 5 U.S.C. §§ 551-59 (1994).

and-comment procedure.⁶⁵ The SEC must issue a public notice of a proposed rule, receive and consider comments from interested persons, and publish a statement of the rule's basis and purpose when the rule is issued.⁶⁶ These procedures apply to amendments of existing rules, as well as to their original promulgation.⁶⁷

The original adoption of Regulation CE was consistent with the Administrative Procedure Act; the SEC followed the required notice and comment procedures.⁶⁸ However, Regulation CE is structured so that it may effectively be "amended" through changes to the underlying California statute and regulations without further SEC involvement. If the California Commissioner of Corporations or the California Legislature amends the section 25102(n) exemption or the regulations to which it refers, the substance of the federal Regulation CE exemption will change without further SEC action. This "amendment" to Regulation CE, enacted without following the notice-and-comment procedures, would arguably violate the Administrative Procedure Act.

Though no cases have yet raised this issue—probably because delegations of this sort are so rare—it is easy to see why the APA should constrain such a rule. It would be too easy to circumvent the APA's requirements. A federal agency eager to avoid the notice-and-comment requirements could simply adopt a general rule incorporating an external standard and, with the cooperation of the external standard-setter, amend the rule at will without following rule-making procedures. Regulation CE was not adopted to circumvent the APA, but the possibility of amending it without SEC involvement provides a strong reason to question Regulation CE's structure.

D. *A Practical Answer to These Problems*

Whatever the merits of constitutional challenges and APA objections to Regulation CE, the practical answer is that a challenge to Regulation CE is unlikely. Neither the SEC, which adopted the exemption, nor issuers of securities, who benefit from the exemption, will challenge it. Purchasers of securities in Regulation CE offerings would have an incentive to challenge the rule if it would allow them to rescind their

65. *See id.* § 553(b), (c).

66. *See id.*; *see also* DAVIS & PIERCE, *supra* note 47, § 7.1.

67. For purposes of the Administrative Procedure Act, "'rule making' means agency process for formulating, *amending*, or repealing a rule." 5 U.S.C. § 551(5) (emphasis added). *Accord* JAMES T. O'REILLY, ADMINISTRATIVE RULEMAKING: STRUCTURING, OPPOSING, AND DEFENDING FEDERAL AGENCY REGULATIONS §§ 2.03, 18.03 (1983).

68. *See* Securities Act Release No. 7185, *supra* note 2; Securities Act Release No. 7285, *supra* note 2.

purchases under section 12(a)(1) of the Securities Act,⁶⁹ but section 19(a) of the Securities Act protects issuers acting in good faith.⁷⁰ Since none of the interested parties has a motive to challenge Regulation CE, it is unlikely its validity will be tested.

IV. REGULATION CE AND "COVERED SECURITIES"

In 1996, Congress amended section 18 of the Securities Act⁷¹ to prohibit the application of most state registration requirements to "covered securities."⁷² Securities issued pursuant to the Regulation CE exemption are not automatically covered securities;⁷³ however, securities issued in a Regulation CE transaction might be covered securities under other parts of the definition.⁷⁴ Securities listed on the New York or American Stock Exchanges, other designated exchanges, or the National Market System of NASDAQ, are covered securities, as are securities equal in seniority or senior to such listed securities.⁷⁵ A Regulation CE offering could involve such securities. More importantly, section 18(b)(3) of the Securities Act provides that "[a] security is a covered security with respect to the offer or sale of the security to qualified purchasers, as defined by the Commission by rule."⁷⁶ The SEC has not yet defined the term "qualified purchaser," and the section 18 definition might not be identical to that in California's section 25012(n), but there is bound to be some overlap. Thus, a Regulation CE offering could involve "qualified purchasers" within the meaning of section 18(b)(3).

Revised section 18 of the Securities Act preempts state laws requiring the registration or qualification of covered securities.⁷⁷ State

69. 15 U.S.C. § 77l(a)(1) (1994).

70. The relevant portion of the section provides:

No provision of this Act imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, . . . be determined by judicial or other authority to be invalid for any reason.

15 U.S.C. § 77s(a).

71. 15 U.S.C. § 77r (West Supp. 1996).

72. *See id.*

73. *See id.* § 77r(b)(4) (providing that "covered securities" include securities in certain exempt transactions).

74. Section 18(b)(2) of the Securities Act, 15 U.S.C. § 77r(b)(2), including securities issued by registered investment companies as covered securities, is not available. California section 25102(n) is not available to investment companies subject to the Investment Company Act of 1940. CAL. CORP. CODE § 25102(n)(1) (Deering 1997).

75. *See* 15 U.S.C. § 77r(b)(1)(A)-(C) (West Supp. 1996); *see also id.* § 77r(d)(4) (defining "senior securities").

76. *Id.* § 77r(b)(3).

77. *See id.* § 77r(a)(1).

antifraud authority is preserved,⁷⁸ and the state may also collect filing or registration fees,⁷⁹ and require the filing of "any document filed with the Commission pursuant to this title, together with annual or periodic reports of the value of securities" sold or offered in the state.⁸⁰ However, no filing or registration fee may be required for a security that is listed on the New York Stock Exchange, the American Stock Exchange, or the National Market System of NASDAQ, or that is equal in seniority or senior to such a listed security.⁸¹

Assume, for example, that a California issuer is offering only covered securities. Since section 18(a) of the Securities Act preempts state registration or qualification requirements,⁸² the California section 25102(n) exemption is unnecessary at the state level. In fact, section 25102(n) is probably a law "with respect to" registration or qualification⁸³ and, therefore, is itself preempted as to covered securities.

Because section 18(a) does not affect federal registration requirements, the issuer would still need a federal exemption, even for covered securities. The issuer may utilize the Regulation CE exemption only if the issuer complies with the conditions of section 25102(n), so Regulation CE reinstates the California state requirements through the back door.

But can the SEC do this? Section 18(a)(1) says that no state law with respect to registration or qualification "shall directly or indirectly apply" to covered securities.⁸⁴ Of course, the SEC is free to formulate its own federal requirements for exemptions, but it has not done so in Regulation CE. Regulation CE applies California law, something that section 18(a) of the Securities Act prohibits. Section 18(a) does not say that the state may not apply its law; it says that state law shall not apply, directly or indirectly.⁸⁵ Rule 1001(a) is, at least, an indirect application of California section 25102(n).

Section 18(c) of the Securities Act does not save the federal rule. The notice filing required by California section 25102(n) is probably acceptable under section 18(c)(2)(A) of the Securities Act,⁸⁶ and the fees are allowed by section 18(c)(2)(B),⁸⁷ but other parts of the section 25102(n) scheme go beyond what section 18 allows for covered securi-

78. *See id.* § 77r(c)(1).

79. *See id.* § 77r(c)(2)(B).

80. *See* 15 U.S.C. § 77r(c)(2)(A) (West Supp. 1996).

81. *See id.* § 77r(c)(2)(D).

82. *See id.* § 77r(a)(1).

83. *See id.*

84. *Id.*

85. *See id.*

86. 15 U.S.C. § 77r(c)(2)(A) (West Supp. 1996).

87. *Id.* § 77r(c)(2)(B).

ties. The disclosure document provided to natural persons, although based on the Regulation D disclosure requirements, is not a document filed with the SEC; therefore, the requirement that it be furnished to the California Commissioner is beyond the scope of section 18(c)(2)(A) of the Securities Act.⁸⁸ The California limitations on solicitation are also prohibited by section 18(a)(2)(A) of the Securities Act.⁸⁹ If the covered securities are section 18(b)(1) securities, or securities equal in seniority or senior to section 18(b)(1) securities, even the notice filing and state fees are not allowed.⁹⁰

The SEC might argue that an issuer's compliance with section 25102(n) is voluntary—done solely to obtain the federal Regulation CE exemption. This position, however, would be inconsistent with the SEC staff's own interpretation of section 18. In informal communications, the SEC staff has indicated that the section 3(a)(10) exemption, available where there is a state fairness hearing on an offering, is not available for covered securities because section 18 of the Securities Act preempts states from conducting such fairness hearings.⁹¹ The SEC specifically rejected the argument that such fairness hearings are acceptable because they are voluntary, not mandatory.⁹²

In short, Regulation CE, in the guise of offering a federal exemption, requires issuers to comply with state provisions that section 18 of the Securities Act says shall not apply. The SEC could have imposed such requirements directly. But, requiring compliance with California state law violates section 18 when the offering involves covered securities.

V. INTERPRETIVE PROBLEMS

Even if Regulation CE is valid, the federal-state coordination it fashions creates some difficult interpretive problems. The "aggregate offering price" of a Regulation CE offering is calculated differently from other exemptions, raising some troublesome problems. In addition, the

88. *Id.* § 77r(c)(2)(A).

89. *Id.* § 77r(a)(2)(A). Under amended section 18, "states could not require specific legends on any offering documents or, perhaps even more extreme, demand that certain financial disclosures be included in the offering documents relating to covered securities even with respect to the offers and sales of covered securities within their own borders." Rutheford B. Campbell, Jr., *Blue Sky Laws and the Recent Congressional Preemption Failure*, 22 J. CORP. L. 175, 199 (1997).

90. See 15 U.S.C. § 77r(c)(2)(D).

91. See SEC Division of Corporate Finance, *Staff Legal Bulletin No. 3* (visited Feb. 6, 1998) <<http://www.sec.gov/rules/other/slbcf3.txt>>; Bradford P. Weirick & Brian J. Kim, *1996 Act Preempts Section 3(a)(10) Fairness Hearing Exemption for Listed Companies*, 11 INSIGHTS No. 5 24, 25 (1997).

92. See SEC Division of Corporate Finance, *supra* note 91.

application of the integration doctrine to Regulation CE offerings is unclear. Some of these problems could have been avoided if the SEC had simply created its own federal requirements for exemption, rather than having incorporated California law.

A. *Problems in Calculating the Aggregate Offering Price of a Regulation CE Offering*

The aggregate offering price in a Regulation CE offering is limited to \$5 million,⁹³ a seemingly simple requirement that, nevertheless, contains some complications not present in other SEC rules. First, the SEC has indicated that state law should be used in some cases to calculate the aggregate offering price, even though there is no directly applicable state law. Second, the aggregate offering price of a Regulation CE offering is calculated differently from any other federal exemption with offering price limits, and this novel method of calculation is more difficult.

1. NON-CASH CONSIDERATION AND THE USE OF STATE LAW

The SEC release adopting Regulation CE indicates that, at least for some purposes, an issuer must look to state law to determine the aggregate offering price of a Regulation CE offering. According to the release, "[w]here a transaction involves non-cash consideration, the amount of the offering would be calculated as provided under California law."⁹⁴ This is a troublesome position for at least two reasons. First, absolutely nothing in Rule 1001 alerts an issuer to this position. Second, California section 25102(n) does not have an aggregate offering price limit; thus, it is unclear what California law the SEC expects issuers to consult. The only California exemptions dependent on aggregate offering price involve cross-references to the limits in federal exemptions.⁹⁵ The aggregate price of an offering is significant under California law in determining eligibility for small corporate offering registration ("SCOR")⁹⁶ and in calculating registration fees,⁹⁷ but the only California provision that deals with non-cash consideration merely gives the Commissioner of Corporations the authority to calculate fees based on the actual value of the securities.⁹⁸ This authority is irrelevant to Regulation CE offerings because they are exempt from state registration require-

93. See 17 C.F.R. § 230.1001(b) (1997).

94. Securities Act Release No. 7285, *supra* note 2, at 88,009 n.30.

95. See CAL. CORP. CODE §§ 25101(c)(1) (aggregate offering price of securities sold pursuant to Regulation A), 25104(h) (same), 25113(b)(2)(B) (aggregate offering price of securities sold pursuant to Rule 504) (Deering 1997).

96. See *id.* § 25113(b)(2)(B).

97. See *id.* § 25608.

98. See *id.* § 25608(g)(1), (h)(2).

ments and the section 25102(n) filing fee does not depend on the amount of the offering.

Thus, the effect of the SEC's cryptic reference to California law is uncertain—a real risk to an issuer whose offering involves non-cash consideration. A more sensible approach would have been to adopt the existing federal formula used to calculate the aggregate offering prices of Regulation A and Regulation D offerings.⁹⁹

2. A NEW WAY TO CALCULATE AGGREGATE OFFERING PRICE

Regulation CE is not the only federal exemption to limit the aggregate offering price of exempt offerings. Regulation A and Rules 504 and 505 of Regulation D all limit the size of the offering.¹⁰⁰ These exemptions, including Regulation CE, require that the available maximum offering price be reduced by the amount of certain other sales of securities. The determination of which other sales reduce the available limit is sometimes referred to as aggregation. Calculating the available aggregate offering price of a Regulation CE offering is quite different from, and more difficult than, the calculation under other federal exemptions.

Under the traditional approach, the available aggregate offering price is determined on a temporal basis. Certain sales of securities within a specified time period reduce the available aggregate offering price. Rule 504, for example, provides for an aggregate offering price of \$1 million, "less the aggregate offering price for all securities sold within the twelve months before the start of and during the offering of securities under this Rule 504, in reliance on any exemption under section 3(b), or in violation of section 5(a) of the Securities Act."¹⁰¹ Rule 505's aggregate price provision is substantially the same, except for the dollar amount.¹⁰² Regulation A takes a similar temporal approach, although only other Regulation A sales in the relevant period must be subtracted.¹⁰³ Under these provisions, any sales outside of the specified time period are irrelevant. Within the specified period, it does not matter if the two offerings are part of the same offering or completely unre-

99. See 17 C.F.R. §§ 230.251(b) note (providing formula for aggregate offering price), 230.501(c) (1997).

100. See *id.* §§ 230.251(b), 230.504(b)(2), 230.505(b)(2)(i).

101. *Id.* § 230.504(b)(2).

102. See *id.* § 230.505(b)(2)(i).

103. The aggregate offering price is \$5 million, "less the aggregate offering price for all securities sold within the twelve months before the start of and during the offering of securities in reliance upon Regulation A." *Id.* § 230.251(b). The SEC's Task Force on Disclosure Simplification proposed to make Regulation A more like Regulation CE, with a \$5 million limit *per offering* rather than \$5 million within a specific time period. See *Report on the Task Force on Disclosure Simplification* 66 (visited Feb. 6, 1998) <<http://www.sec.gov/news/studies/smpl.htm>>.

lated; they must be considered in calculating aggregate offering price. Thus, if an issuer sold \$1 million of securities in a Rule 504 offering on January 1 and wanted to do a Rule 505 offering on September 1 of the same year, he could sell only \$4 million worth of securities, even if the two offerings were completely separate under standard integration analysis.¹⁰⁴

Regulation CE rejects the traditional temporal approach in favor of a transactional approach. Rule 1001 computes aggregate offering price on an offering-by-offering basis. The aggregate offering price is limited to \$5 million, "less the aggregate offering price for all other securities sold in the same offering of securities, whether pursuant to this or another exemption."¹⁰⁵ Standard integration analysis is used to determine whether sales of securities are part of the same offering.¹⁰⁶ Thus, Regulation CE essentially conflates the concepts of aggregate offering price and integration. Aggregation depends on integration—i.e., whether two ostensibly separate offerings would be considered part of the same offering. When the SEC proposed Rule 1001, it acknowledged that its method of determining the aggregate offering price differed from the traditional approach.¹⁰⁷ The SEC justified this offering-by-offering approach as a way "to more closely parallel the California exemptive provision."¹⁰⁸ This explanation is disingenuous since the section 25102(n) exemption has no aggregate offering price limit.

This transactional approach to calculating aggregate offering price can be either more or less restrictive than the traditional temporal tests. It allows Regulation CE to be used contemporaneously with another exemption without reducing Regulation CE's \$5 million limit, as long as the two offerings would not be integrated. To modify the prior example, if an issuer sold \$1 million of securities pursuant to Regulation CE (or some other exemption) on January 1, it could still offer \$5 million pursu-

104. The two offerings would be protected from integration by Rule 502(a) because they are more than six months apart and there are no intervening sales. See 17 C.F.R. § 230.502(a) (1997).

105. *Id.* § 230.1001(b).

106. See Securities Act Release No. 7285, *supra* note 2, at 88,009 n.31. The SEC uses a five-factor test to determine whether two or more transactions should be integrated and treated as a single offering. The five-factor test considers "whether (1) the different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, and (5) the offerings are made for the same general purpose." Non-Public Offering Exemption, Securities Act Release No. 4552, 1 Fed. Sec. L. Rep. (CCH) ¶¶ 2770-83, at 2781 (Nov. 6, 1962). *Accord* Exemption for Local Offering from Registration, Securities Act Release No. 4434, 1 Fed. Sec. L. Rep. (CCH) ¶¶ 2270-77, at 2272 (Dec. 6, 1961). All five factors do not have to be present to integrate offerings; the SEC has indicated that "[a]ny one or more" of the factors may be determinative. See *id.*

107. See Securities Act Release No. 7185, *supra* note 2, at 86,874.

108. *Id.*

ant to Regulation CE on the next day, as long as the two offerings were not part of the same offering. A single issuer selling \$5 million of securities on January 1, another \$5 million on July 1, and another \$5 million on December 31, all pursuant to Regulation CE, would not violate the Regulation CE aggregate offering price limit, if under "[s]tandard integration analysis concepts,"¹⁰⁹ the issuer could demonstrate that the offerings were separate.

The transactional approach to determining aggregate offering price can also restrict the exemption, however. Assume, for example, that an issuer sold \$1 million of securities pursuant to Regulation CE (or any other exemption) on January 1, 1997. If, on January 15, 1998, it wishes to sell the same class of securities pursuant to Regulation CE, it might be limited to \$4 million. Under Rule 1001(b), unlike Regulation A and Regulation D, the passage of twelve months is not necessarily determinative—separation in time is only one factor among others considered in deciding whether two offerings should be integrated.¹¹⁰ If the other four integration factors are met, the two sales might be considered part of the same offering even though they are more than a year apart. If so, the \$1 million sold in 1997 must be subtracted from the \$5 million aggregate offering price available for the 1998 offering.

Although the SEC releases are silent on the issue, an integration safe harbor could probably be used with Rule 1001 to keep two offerings separate, preserving the full \$5 million aggregate offering price. Regulation CE does not have its own integration safe harbor, but other federal exemptions do. Assume, for example, that an issuer sold \$5 million of securities on January 1, pursuant to the Regulation CE exemption. One month later, it sold another \$5 million pursuant to Regulation A. Under the standard five-factor integration analysis, the two offerings might be integrated; however, Rule 251(c)(1) of Regulation A provides that Regulation A offerings will not be integrated with prior offers or sales of securities.¹¹¹ This integration safe harbor appears to be two-sided, protecting both the Regulation A sales and the Regulation CE sales.¹¹² The Regulation CE sales would not affect the \$5 million limit in Regulation A, because Regulation A's aggregate offering price is only reduced by the amount of other Regulation A sales.¹¹³ The Regulation A offering would not affect the \$5 million limit in Regulation CE, because its aggregate offering price is only reduced by the amount of securities sold

109. Securities Act Release No. 7285, *supra* note 2, at 88,009 n.31.

110. See *supra* note 106 and accompanying text.

111. See 17 C.F.R. § 230.251(c)(1) (1997).

112. See C. Steven Bradford, *Regulation A and the Integration Doctrine: The New Safe Harbor*, 55 OHIO ST. L.J. 255, 270-73 (1994).

113. See 17 C.F.R. § 230.251(b).

in the same offering,¹¹⁴ and, by virtue of the Rule 251(c) integration safe harbor, the Regulation A sales are not considered part of the same offering. The SEC release adopting Rule 1001 clearly specifies that standard integration analysis will be used to determine what is part of the same offering, and integration safe harbors are part of that standard analysis.

This analysis only works with the Regulation A integration safe harbor, however. Other integration safe harbors are one-sided, protecting only the exemption from integration in which they are contained.¹¹⁵ Thus, if a Regulation D offering and a Regulation CE offering were seven months apart, the Rule 502(a) integration safe harbor¹¹⁶ would protect the Regulation D offering from violation, but it would not separate the offerings for purposes of the Regulation CE aggregate offering price determination. Thus, Regulation CE's aggregate offering price limit would still have to be reduced by the amount of the Regulation D offering, if, under the five-factor test, the two offerings would be integrated.

B. *Integration Problems*

Regulation CE presents difficult integration issues independent of the \$5 million aggregate offering price limit. First, some of the language in Rule 1001 seems inconsistent with traditional integration analysis, yet the SEC has not explained that language or its effect. Another problem is created by the interaction of federal and California law. What happens if offerings would be integrated under California law but not under federal law?

1. DOES REGULATION CE MODIFY OR ELIMINATE THE INTEGRATION DOCTRINE?

Ordinarily, the integration doctrine prevents an issuer from artificially splitting a single offering into two, then using a separate exemption for each part. Assume, for example, that an issuer tries to sell \$5 million of stock, \$2.5 million pursuant to the section 3(a)(11) intrastate offering exemption, and \$2.5 million pursuant to Rule 1001. The Regulation CE aggregate offering price limit is not a problem, even if the two offerings are integrated, because the two combined offerings total only \$5 million. However, under traditional integration analysis, the entire offering must qualify for a single exemption. If the two groups of sales would be integrated under the five-factor test and no integration safe harbor is available, the entire \$5 million offering would have to qualify

114. See *id.* § 230.1001(b).

115. See Bradford, *supra* note 112, at 270-72.

116. 17 C.F.R. § 230.502(a).

for a single exemption. The section 3(a)(11) exemption would not be available for the entire offering if some of the Regulation CE offerees resided in different states and the Regulation CE exemption would not be available if some of the section 3(a)(11) purchasers were not qualified purchasers. Since no single exemption is available for the entire offering, registration would be required.

It is unclear if Regulation CE follows this traditional integration analysis. The only references to integration in the Regulation CE releases relate to the aggregate offering price limit.¹¹⁷ This omission would ordinarily be insignificant, since the integration doctrine is well established and most securities lawyers would simply assume it applies. However, Rule 1001 contains some curious language that appears to be inconsistent with traditional integration analysis.

As previously discussed, the aggregate offering price in a Regulation CE offering is limited to \$5 million, "less the aggregate offering price for all other securities sold in the same offering of securities, whether pursuant to this or another exemption."¹¹⁸ It is the last clause—"whether pursuant to this or another exemption"—which poses a problem. Ordinarily, as a result of the integration doctrine, all securities sold in the same offering must qualify under a single exemption. But, if the entire offering must qualify under Regulation CE, what does the reference to sales under "another exemption" mean? The SEC apparently contemplated that part of an offering could be exempted under Regulation CE and part under some other exemption (as long as the two parts total to less than \$5 million). Unfortunately, the SEC releases are silent on the meaning of this language.¹¹⁹ Until the SEC explains this novel language, the application of integration rules to Regulation CE offerings will remain uncertain.

2. CONFLICTS BETWEEN FEDERAL AND STATE INTEGRATION ANALYSIS

The previous discussion assumed that integration issues should be resolved by federal law. But, given Regulation CE's incorporation of California law, California integration law cannot be ignored. Issuers must consider whether California would integrate the securities offerings

117. See Securities Act Release No. 7185, *supra* note 2, at 86,784 n.28; Securities Act Release No. 7285, *supra* note 2, at 88,009 n.31.

118. 17 C.F.R. § 230.1001(b) (1997).

119. One possible meaning is that the dollar amount of other sales must be subtracted even if an integration safe harbor protects them from integration. However, the existence of an integration safe harbor usually indicates that the sales are not part of the same offering, making Rule 1001(b) inapplicable even with the ending clause. See, e.g., *id.* § 230.502(a) (providing that offers and sales protected by the integration safe harbor "will not be considered part of that Regulation D offering").

and what happens when two offerings would not be integrated under federal law, but would be integrated under California law.

California uses the integration concept in interpreting its securities law exemptions.¹²⁰ The California Commissioner of Corporations, interpreting the California limited offering exemption,¹²¹ indicated that:

The "transaction" referred to is one or more offers or sales of a security which have such a connection with each other as to be considered one transaction for statutory purposes. . . . It is the statutory concept of "transaction" which determines whether or not other offers or sales of securities, past, present or future, will be considered as constituting a part of the transaction under the exemption and integrated with it and whether such integration will result in a violation of any of the limitations of the exemption.¹²²

This release, and other California authorities, follow the SEC's five-factor test.¹²³ California authorities have yet to apply integration concepts to the section 25102(n) exemption, but there is no obvious reason why the subsection (n) exemption should be treated differently from the subsection (f) limited offering exemption. The transactional language in the two exemptions is almost identical.¹²⁴

The fact that two offerings would not be integrated under federal law does not necessarily mean that they will not be integrated under California law. First, the federal integration safe harbors are not available. A California regulation applicable to the section 25102(f) limited offering exemption provides a safe harbor from integration similar to

120. See, e.g., *Sherman v. Lloyd*, 226 Cal. Rptr. 495 (Cal. Ct. App. 1986) (integrating offerings of separate partnerships for purposes of the section 25102(f) limited offering exemption); *Tomei v. Fairline Feeding Corp.*, 137 Cal. Rptr. 656 (Cal. Ct. App. 1977) (sales in the two preceding years considered in determining whether the section 25102(f) exemption was available); California Commissioner of Corporations, Opinion No. 73/120C, 1973 WL 3058 (Oct. 2, 1973) (offerings of separate partnerships integrated for purposes of the section 25102(f) exemption); California Commissioner of Corporations, Opinion No. PL/34, 1970 WL 2504 (Jan. 26, 1970) (same). See generally Willie R. Barnes, *The California Corporate Securities Law: An Overview of the Private Placement Exemption and Other Select Exemptions from Qualification*, in *Practicing Law Institute, PRIVATE PLACEMENTS 1996*, 933 PLI/Corp 531 [Westlaw], at *561 (1996).

121. See CAL. CORP. CODE § 25102(f) (Deering 1997).

122. California Commissioner of Corporations, Release No. 67-C (Oct. 20, 1981), *reprinted in* 1 BLUE SKY L. REP. (CCH) ¶ 12,558, at 8054-55.

123. See *Sherman*, 226 Cal. Rptr. 495; California Commissioner of Corporations, Release No. 67-C, *supra* note 122, at 8055; California Commissioner of Corporations, Opinion No. 80/8C, 1980 WL 6385, at *2 (Sept. 30, 1980). See also Barnes, *supra* note 120, at *560-61.

124. Subsection (f) exempts "[a]ny offer or sale of any security in a transaction . . . that meets each of the following criteria" CAL. CORP. CODE § 25102(f) (emphasis added). Subsection (n) exempts "[a]ny offer or sale of any security in a transaction . . . that meets all of the following criteria" *Id.* § 25102(n) (emphasis added).

some of the federal safe harbors,¹²⁵ but that safe harbor is not available to section 25102(n) offerings. Second, the California Commissioner of Corporations has refused to hold that the federal five-factor test is the sole test for integration under California law.¹²⁶ In deciding whether to integrate two offerings, California appears to consider factors in addition to those in the SEC's five-factor test.¹²⁷ This could lead to differing results at the federal and state levels. Finally, the five-factor test is notoriously vague and uncertain,¹²⁸ making it likely that the federal and state positions on the integration of two particular offerings could differ, even if the SEC and the state each apply the customary five-factor test.

What happens if a Regulation CE offering would not be integrated with another offering under federal law, but would be integrated with that offering under California law? Assume, for example, that an issuer makes two ostensibly separate offerings of securities, Offering A and Offering B. Offering A, considered alone, fully complies with Regulation CE and section 25102(n). Offering B, considered alone, fully complies with federal Rule 504, but has no California state exemption. Assume further that under federal integration law, Offering A and Offering B are treated as separate offerings, but, under California law, the two offerings would be integrated. Clearly, the California state exemption is lost; whether section 25102(n) is satisfied for state law purposes is wholly within California's purview. Although Offering A alone complies with section 25102(n), the combined offering does not. Since California treats Offerings A and B as a single offering, the section 25102(n)

125. See CAL. CODE REGS. tit. 10, § 260.102.12, reprinted in 1 BLUE SKY L. REP. (CCH) ¶ 11,780A (1997).

126. California Commissioner of Corporations, Opinion 80/8C, 1980 WL 6385, at *2.

127. In deciding whether to integrate offerings by separate entities, California considers two additional factors, referred to as the "pool of investors" and "ongoing program" factors. See Barnes, *supra* note 119, at *561. The California Commissioner of Corporations has refused to exempt offerings by a particular limited partnership where "the existence of a pool of investors tends toward the conclusion that . . . [the promoters] . . . have an ongoing program of offering and selling limited partnership interests" in the various partnerships. California Commissioner of Corporations, Opinion No. 74/57C, 1974 WL 3085, at *2 (May 23, 1974).

128. According to Rutheford B. Campbell, Jr.:

Everyone seems to agree that these criteria are nearly impossible to apply, principally because neither the Commission nor the courts have ever adequately articulated how these factors are to be weighed or how many factors must be present in order for integration to occur. As a result, the area remains confusing and dangerous.

The Commission especially has been criticized in this regard, as commentators have uncovered what appear to be glaring inconsistencies in no-action letters from the staff.

Rutheford B. Campbell, Jr., *The Plight of Small Issuers (and Others) Under Regulation D: Those Naggling Problems That Need Attention*, 74 KY. L.J. 127, 164 (1985-86). See generally Bradford, *supra* note 112, at 265-66, and authorities cited therein.

state exemption is not available. But what happens to the federal exemption available to Offering A under Regulation CE? Is it automatically lost because the state-level exemption is not available? Although Regulation CE can be read either way, the probable answer is yes. Even though the two offerings would not be integrated under federal law, integration at the state level eliminates the Regulation CE exemption.

Rule 1001(a) provides that “[o]ffers and sales of securities that *satisfy the conditions of* [section 25102(n)] and paragraph (b) of this rule,” shall be exempt from registration.¹²⁹ This language may be read in two ways. One possible interpretation is that only the offers and sales for which the Regulation CE exemption is sought must “satisfy the conditions” of California section 25102(n). Rule 1001(a) only requires that the “[o]ffers and sales of securities” exempted by Regulation CE satisfy the conditions of section 25102(n), not the entire transaction of which they are a part. Under this discrete view, any other offers and sales that might be part of the same offering, but for which the issuer does not seek to use Regulation CE, may be ignored. The other sales do not have to meet the requirements of section 25102(n) and, as long as there is no federal integration problem, California’s views on integration are irrelevant.

The alternative interpretation focuses on the transactional nature of the section 25102(n) exemption. Offers and sales are exempted by California section 25102(n) only if the entire transaction of which they are a part meets all the requirements of subsection (n); one can determine the transaction of which they are a part only by applying California integration doctrine. If the entire transaction, including other offers and sales which California says should be integrated, does not comply with subsection (n), then the subsection (n) exemption is not available for any part of the transaction. Under this transactional view, since the conditions of 25102(n) have not been satisfied, the Regulation CE exemption is also unavailable.

The SEC’s Regulation CE releases seem to support the transactional view. Both the proposing and the adopting releases indicate that Rule 1001 exempts offers and sales of securities “that are exempt from registration” under section 25102(n).¹³⁰ Offers and sales would not be exempt under section 25102(n), even if they, alone, satisfied its conditions, if they were part of a broader transaction that, taking into account California state integration law, did not qualify under section 25102(n). The SEC releases further indicate that issuers should “look to the state of

129. 17 C.F.R. § 230.1001(a) (1997) (emphasis added).

130. Securities Act Release No. 7285, *supra* note 2, at 88,009; Securities Act Release No. 7185, *supra* note 2, at 86,873.

California for interpretations relating to who qualifies for the exemption, since any person who lawfully relies on the state exemption also could rely on its federal counterpart."¹³¹ By negative implication, any person who could not lawfully rely on the state exemption could not rely on Regulation CE. The statement in the release that California authorities should be consulted in calculating the aggregate offering price¹³² further buttresses the transactional view's use of California integration law.

On the other hand, the "whether pursuant to this or another exemption" language in Rule 1001(b) seems to contemplate a single offering using both the section 25102(n) conditions of Regulation CE and some other federal exemption. If the entire offering must meet the requirements of section 25102(n), this language is superfluous; there would be no need for sales that are part of the same offering to qualify under "another exemption." Either the entire offering falls within Regulation CE (because the entire offering is exempted by section 25102(n)) or none of the offering qualifies under Regulation CE (because of integration under California law). Thus, the full incorporation view makes the language at the end of Rule 1001(b) superfluous.¹³³

VI. CONCLUSION

Regulation CE is the unfortunate offspring of a good idea and a bad idea. The good idea was to extend the "test-the-waters" concept of Regulation A to offerings to qualified purchasers. The bad idea was to incorporate a California state exemption into the federal exemption system. This misguided approach deprives issuers in forty-nine states of the exemption, raises serious questions about the SEC's authority, and creates difficult interpretive questions that could have been avoided by using a more straightforward approach.

The cure for the problems created by Regulation CE is clear. The SEC should repeal Regulation CE and do what it should have done initially—adopt its own federal exemption for sales to qualified purchasers that allows issuers to "test the waters."

131. Securities Act Release No. 7285, *supra* note 2, at 88,009; Securities Act Release No. 7185, *supra* note 2, at 86,874.

132. *See supra* note 94 and accompanying text.

133. If California ignored out-of-state purchasers for purposes of section 25102(n), then the transactional view could be reconciled with Rule 1001(b). An issuer could sell only to qualified purchasers in California, satisfying section 25102(n), and sell to others outside of California, using a federal exemption. The California limited offering exemption in section 25102(f) expressly includes out-of-state purchasers in its thirty-five-purchaser limit, CAL. CORP. CODE § 25102(f) (1997), but subsection (n) is silent on whether out-of-state sales should be considered part of the "transaction."

APPENDIX: THE DEFINITION OF QUALIFIED PURCHASER

The following are qualified purchasers under section 25102(n):

A. *Persons Related to the Issuer*

1. Any director, executive officer,¹³⁴ or general partner of the issuer, or any director, executive officer, or general partner of a general partner of the issuer;¹³⁵

2. An officer or director of the issuer;¹³⁶

3. A general partner of an issuer which is a partnership, who exercises managerial functions, or a general partner of a general partner of such an issuer;¹³⁷

4. A trustee of an issuer which is a trust, who exercises managerial functions;¹³⁸

5. A person who occupies a position with the issuer, or with a general partner of the issuer which is a partnership, with duties and authority substantially similar to those of an executive officer of a corporation;¹³⁹

6. A "promoter" of the issuer,¹⁴⁰ defined as a person who, alone or with other persons, "takes the initiative in founding or organizing the business or enterprise of an issuer";¹⁴¹

B. *Wealthy or Sophisticated Individuals*

7. Any natural person whose individual net worth, or joint net

134. Executive officers are:

[T]he president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function, or any other person who performs similar policy making functions for the issuer. Executive officers of subsidiaries may be deemed executive officers of the issuer if they perform such policy making functions for the issuer.

17 C.F.R. § 230.501(f) (1997).

135. Section 25102(n) defines "qualified purchaser" to include any person "designated in Section 260.102.13 of Title 10 of the California Code of Regulations. The section 260.102.13 regulations include an accredited investor as defined in Rule 501(a) of Regulation D." CAL. CODE REGS. tit. 10, § 260.102.13(g) (1997). This is one category of accredited investor. See 17 C.F.R. § 230.501(a)(4). [Subsequent notes shall use the term "incorporated by" to indicate that a statute or regulation includes a cross-reference adopting a definition in another statute or regulation.]

136. See CAL. CODE REGS. tit. 10, § 260.102.13(a) (1997), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

137. See *id.*

138. See *id.*

139. See *id.* § 260.102.13(b), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

140. See *id.* § 260.102.13(d), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

141. CAL. CODE REGS. tit. 10, § 260.102.12(f) (1997).

worth with that person's spouse, at the time of the purchase exceeds \$1 million;¹⁴²

8. Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years, or joint income with that person's spouse in excess of \$300,000 in each of those years, and who has a reasonable expectation of reaching the same income level in the current year;¹⁴³

9. A natural person who, either individually or jointly with his or her spouse, has a minimum net worth of \$250,000¹⁴⁴ and gross annual income in excess of \$100,000,¹⁴⁵ subject to certain other limitations;¹⁴⁶

10. A natural person who, either individually or with his or her spouse, has a minimum net worth of \$500,000, subject to the same limitations as the previous category;¹⁴⁷

C. Regulated Institutional Investors

11. A small business investment company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Company Act of 1958;¹⁴⁸

142. See 17 C.F.R. § 230.501(a)(5) (1997), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g) (1997), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

143. See *id.* § 230.501(a)(6), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g) (1997), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

144. Homes, household furnishings, and automobiles are excluded in calculating net worth. See CAL. CORP. CODE § 25102(n)(2)(E). Other assets may be valued at fair market value. See *id.*

145. The investor must have met the income requirement in the immediately preceding tax year and must reasonably expect to meet the requirement again in the current tax year. See CAL. CORP. CODE § 25102(n)(2)(E).

146. See CAL. CORP. CODE § 25102(n)(2)(E). The individual's investment may not exceed ten percent of his net worth. See *id.* In addition, the offering must involve a single-class voting common stock or preferred stock with at least the same voting rights as a single-class voting common stock. See *id.* The investor or the investor's representative also must meet a "sophistication" requirement. The statute provides:

Each such natural person, by reason of his or her business or financial experience, or the business or financial experience of his or her professional advisor, who is unaffiliated with and who is not compensated, directly or indirectly, by the issuer or any affiliate or selling agent of the issuer, can be reasonably assumed to have the capacity to protect his or her interests in connection with the transaction.

Id. Although this might be read as a mere statement of the California Legislature's reason for including this category, the California Commissioner of Corporations reads it as an additional requirement. See California Commissioner of Corporations Release No. 94-C, 1 BLUE SKY L. REP. (CCH) ¶ 12,628, at 8129 (Sept. 27, 1994). Because of the inclusion of federal Rule 501(a) accredited investors as qualified purchasers under section 25102(n), see *supra* text accompanying notes 142-43, individuals with a net worth of more than \$1 million or income in excess of \$200,000 would not have to meet this sophistication requirement. See 17 C.F.R. § 230.501(a)(5), (6) (1997).

147. See CAL. CORP. CODE § 25102(n)(2)(E) (Deering 1997).

148. This type of entity is a "qualified purchaser" through two definitional routes. See CAL. CODE REGS. tit. 10, § 260.102.13(f) (1997), incorporated by CAL. CORP. CODE § 25102(n)(2)(A);

12. A business development company as defined in section 2(a)(48) of the Investment Company Act of 1940;¹⁴⁹

13. A private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;¹⁵⁰

14. Any broker or dealer registered pursuant to section 15 of the Exchange Act;¹⁵¹

15. Any bank as defined in section 3(a)(2) of the Securities Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Securities Act, whether acting in its individual or fiduciary capacity;¹⁵²

16. A bank, savings and loan association, trust company, insurance company, or investment company registered under the Investment Company Act of 1940, or a wholly-owned subsidiary of any of the above, whether the purchaser is acting for itself or as trustee;¹⁵³

17. Any insurance company as defined in section 2(13) of the Securities Act;¹⁵⁴

D. *Employee Benefit Plans and Retirement Accounts*

18. Any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if the plan has total assets in excess of \$5 million;¹⁵⁵

19. Any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if (1) the investment decision is

17 C.F.R. § 230.501(a)(1), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g), incorporated by CAL. CORP. CODE § 25102(n)(2)(A).

149. This category of qualified purchaser is included through two definitional routes. *See id.*

150. This type of entity is a qualified purchaser through two definitional routes. *See* CAL. CODE REGS. tit. 10, § 260.102.13(f), incorporated by CAL. CORP. CODE § 25102(n)(2)(A); 17 C.F.R. § 230.501(a)(2), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g), incorporated by CAL. CORP. CODE § 25102(n)(2)(A).

151. *See* 17 C.F.R. § 230.501(a)(1), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g), incorporated by CAL. CORP. CODE § 25102(n)(2)(A).

152. *See id.*

153. Under section 25102(n)(2)(B), a person designated in section 25102(i), or any rule of the Commissioner adopted thereunder, is a qualified purchaser. *See* CAL. CORP. CODE § 25102(n)(2)(B) (Deering 1997). Subsection (i) exempts offers or sales to each of the entities listed in the text. *See id.* § 25102(i)(1). The Commissioner of Corporations has extended the exemption to a wholly-owned subsidiary of any of the listed institutions. *See* CAL. CODE REGS. tit. 10, § 260.102.10(c) (1997).

Registered investment companies are also qualified purchasers through another definitional route. *See* 17 C.F.R. § 230.501(a)(1) (1997), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g), incorporated by CAL. CORP. CODE § 25102(n)(2)(A).

154. *See* 17 C.F.R. § 230.501(a)(1), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g), incorporated by CAL. CORP. CODE § 25102(n)(2)(A).

155. *See id.*

made by a plan fiduciary, as defined in section 3(21) of that Act, which is either a bank, savings and loan association, insurance company, or registered investment adviser; (2) the plan has total assets in excess of \$5 million; or (3) the plan is a self-directed plan with investment decisions made solely by persons that are accredited investors as defined by Rule 501(a) of Regulation D;¹⁵⁶

20. A pension or profit-sharing trust, or its wholly-owned subsidiary (other than a pension or profit-sharing trust of the issuer of the securities, a self-employed individual retirement plan, or an individual retirement account), whether it is acting for itself or as trustee;¹⁵⁷

21. A pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or an individual retirement account, if the investment decisions are made solely by qualified purchasers;¹⁵⁸

E. Other Entities

22. Any trust, with total assets in excess of \$5 million, not formed for the specific purpose of acquiring the securities offered, if the purchase is directed by a person who "either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment";¹⁵⁹

23. Any section 501(c)(3) charitable organization, corporation, Massachusetts or similar business trust, or partnership with total assets in excess of \$5 million, provided it was not formed for the specific purpose of acquiring the securities offered;¹⁶⁰

24. A corporation, Massachusetts or similar business trust, partnership, or section 501(c)(3) charitable organization with total assets in excess of \$5 million, according to its most recent audited financial statements;¹⁶¹

25. A section 501(c)(3) charitable organization with total assets (including endowment, annuity and life income funds) of at least \$5 million, according to its most recent audited financial statement;¹⁶²

156. *See id.*

157. Offers or sales to such pension or profit-sharing trusts are exempt under section 25102(i)(1). *See supra* note 153 and accompanying text.

158. *See* CAL. CORP. CODE § 25102(n)(2)(C).

159. 17 C.F.R. § 230.501(a)(7) (1997), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g) (1997), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997). The sophistication standard comes from 17 C.F.R. § 230.506(b)(2)(ii). For restrictions on who may act as a purchaser representative, *see id.* § 230.501(h).

160. *See* 17 C.F.R. § 230.501(a)(3), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g), incorporated by CAL. CORP. CODE § 25102(n)(2)(A).

161. *See* CAL. CORP. CODE § 25102(n)(2)(D).

162. *See* CAL. CODE REGS. tit. 10, § 260.102.10(a), incorporated by CAL. CORP. CODE

26. A corporation with a net worth on a consolidated basis of at least \$14 million, according to its most recent audited financial statement;¹⁶³

27. A corporation with outstanding securities registered under section 12 of the Exchange Act, or its wholly-owned subsidiary;¹⁶⁴

F. Minimum Purchase Requirements

28. Anyone who purchases \$150,000 or more of the securities offered, if either (1) the purchaser or his professional adviser¹⁶⁵ by reason of their business or financial experience have the capacity to protect the purchaser's interests¹⁶⁶ or (2) the investment does not exceed ten percent of the purchaser's net worth;¹⁶⁷

§ 25102(n)(2)(B). Except for 501(c)(3) organizations with *exactly* \$5 million in assets, this category is probably subsumed within the prior item.

163. See CAL. CODE REGS. tit. 10, § 260.102.10(b), incorporated by CAL. CORP. CODE § 25102(n)(2)(B). The regulation contains some additional requirements where the offering constitutes common stock of a corporation or securities exchangeable for, or convertible into, the common stock of a corporation. See CAL. CODE REGS. tit. 10, § 260.102.10(b). It is not clear if these transactional restrictions will be incorporated into subsection (n). See *supra* note 13.

This category probably adds nothing in any event. Corporations with assets in excess of \$5 million are already included in Category 24. A corporation with a balance sheet net worth of \$14 million would necessarily have in excess of \$5 million in assets on its balance sheet. See C. STEVEN BRADFORD & GARY ADNA AMES, *BASIC ACCOUNTING PRINCIPLES FOR LAWYERS: WITH PRESENT VALUE AND EXPECTED VALUE* 7-9 (1997).

164. Offers or sales to specified corporations are exempt under section 25102(i)(2). See *supra* note 153 and accompanying text. The subsection (i) exemption requires that the company acquire 100 percent of the issuer's stock. See CAL. CORP. CODE § 25102(i) (Deering 1997). The SEC releases relating to Regulation CE treat the subsection (n)(2)(B) cross-reference as incorporating this transactional restriction as well. See Securities Act Release No. 7285, *supra* note 2, at 88,008 ("reporting companies under the Securities Exchange Act of 1934 . . . , if the transaction involves the acquisition of all of an issuer's capital stock for investment"). The California Commissioner of Corporations apparently does not believe that the cross-reference is meant to incorporate the transactional restriction. In a release interpreting subsection (n), the Commissioner included as qualified purchasers "corporations with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934," without mentioning the 100-percent-purchase requirement. See California Commissioner of Corporations Release No. 94-C, 1 BLUE SKY L. REP. (CCH) ¶ 12,628, at 8128 (Sept. 27, 1994).

165. The term "professional advisor" has been defined for purposes of another California exemption as "a person who, as a regular part of such person's business, is customarily relied upon by others for investment recommendations or decisions, and who is customarily compensated for such services, either specifically or by way of compensation for related professional services, and attorneys and certified public accountants." CAL. CODE REGS. tit. 10, § 260.102.12(g) (1997). The definition includes licensed or registered broker-dealers, agents, investment advisers, banks, savings and loan associations, and licensed real estate brokers as to certain securities. See *id.* § 260.102.12(g)(1). The purchaser must specifically designate the person as his professional adviser. See *id.* § 260.102.12(g)(2).

166. See CAL. CODE REGS. tit. 10, § 260.102.13(e)(1), incorporated by CAL. CORP. CODE § 25102(n)(2)(A). This regulation incorporates by reference the "business or financial experience" standard in CAL. CORP. CODE § 25102(f)(2).

167. See CAL. CODE REGS. tit. 10, § 260.102.13(e)(2), incorporated by CAL. CORP. CODE

G. *Persons Related to Other Qualified Purchasers*

29. Any relative,¹⁶⁸ spouse, or relative of the spouse, of another qualified purchaser with the same principal residence;¹⁶⁹

30. Any trust or estate in which collectively more than 50% of the beneficial interest (excluding contingent interests) is owned by a purchaser and any person related to the purchaser as specified in Categories 29 and 31;¹⁷⁰

31. Any corporation or other organization of which collectively more than 50% of the equity securities (excluding director's qualifying shares) or equity interests are owned by a purchaser and any person related to the purchaser as specified in Categories 29 and 30;¹⁷¹

H. *Aggregations of Other Qualified Purchasers*

32. Any entity of which all of the equity owners are accredited investors as defined by Rule 501(a) of Regulation D;¹⁷²

33. Any entity in which all of the equity owners are officers, directors, or affiliates of the issuer, as defined in section 25102(f) of the California Corporation Code; or persons specified in section 25102(i) of the California Corporation Code, section 26.102.10 of the California regulations, or sections 260.102.13(a)-(d),(f), and (g) of the California regulations [collectively, Categories 1-8, 11-20, 22-23, 25-27, and 29-31 above];¹⁷³

I. *Additional Exemptive Authority*

34. Anyone else the California Commissioner of Corporations designates by rule as qualified.¹⁷⁴

§ 25102(n)(2)(A). The net worth of the purchaser's spouse may be included for purposes of the ten percent calculation. *See id.*

168. "Relative" means a person related by blood, marriage, or adoption. *See* CAL. CODE REGS. tit. 10, § 260.102.13(c)(3).

169. *See* CAL. CODE REGS. tit. 10, § 260.102.13(c)(1) (1997), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

170. *See id.* § 260.102.13(c)(2), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

171. *See id.* § 260.102.13(c)(3), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

172. *See* 17 C.F.R. § 230.501(a)(8) (1997), incorporated by CAL. CODE REGS. tit. 10, § 260.102.13(g), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

173. CAL. CODE REGS. tit. 10, § 260.102.13(h), incorporated by CAL. CORP. CODE § 25102(n)(2)(A) (Deering 1997).

174. *See* CAL. CORP. CODE § 25102(n)(2)(F).